Metro Construction Market Analysis 2020

COVID-19 Special Addendum

May 21, 2020

COVID-19 UPDATE

Metro Construction Projects are considered essential and still moving forward.

GET UPDATES

Overview

Early this year, Metro had just completed its Construction Market Analysis 2020, a 2-year update that assesses the current and future state of the economy, identifies Metro's progress in response to tight construction market conditions, and outlines strategies for keeping Metro's capital program, especially megaprojects, on track over the next 10 years.

Meanwhile, the emerging COVID-19 pandemic posed an uncertain concern. Soon after, the dramatic economic effects became starkly clear.

This addendum provides an updated snapshot of the unprecedented and evolving global pandemic's effect on the state of the economy and construction market:

- Summary of the most current information available for COVID-19-related impacts
- Outlooks for key economic and construction market indicators
- Metro-centric circumstances and perspectives relative to its project construction goals, along with potential actions Metro may consider in response to this historic and dynamic global event.

The information presented in this addendum was current at the time it was completed on April 15, 2020.

State of the Economy

Impacts

The COVID-19 pandemic has created economic risks still not well understood by economist around the country. However, economist have consensus that a fully functioning economy will not return until people are confident they can resume normal activity without risk of contracting the virus.[i] Some also believe that the dramatic changes occurring are not necessarily resulting from fundamental economic factors. Others expect a depression to occur if the "safer at home" orders last until the summer.

- UCLA's Anderson Forecast spring update reveals that the US gross domestic product (GDP) is tracking to decline by 7.5% in the second quarter (an annual rate of -30%).[ii]
- Dodge Data & Analytics anticipates US GDP to decline by more than 6% in the second quarter.[iii]
- Economists at various global banks project that US GDP will decline between 3% and 24%.[iv]

These predictions are unable to capture potentially positive impacts of federal programs offering loans to businesses that rehire or retain workers. UCLA typically uses historical data from expansions and recessions to develop such forecasts. However, this economic shutdown is unlike any the US has ever experienced, making historical data essentially irrelevant.[v]

Metro

PUBLIC SAFETY ACTIONS SLOW COMMERCE AND MOBILITY

Businesses, consumers, and regulators are acting to limit the spread of the virus by implementing policies that restrict interactions and thus decrease the potential for transmitting the virus. Policies include travel restrictions (especially international), canceling sporting events and live entertainment, public school closures, restaurant and bar closures, and closure of any "non-essential" businesses.

As of April 6, California is one of 43 states that have instituted "safer at home" orders that restrict activity to essential jobs and personal needs such as grocery shopping and medical appointments.[vi]

UNEMPLOYMENT GROWS

The most recent jobs reports and unemployment claims indicate that the number of unemployed workers may reach historic levels in the coming weeks and months. Jobless claims reached over 10 million nationally at the end of March (the first month of the pandemic), jumping more quickly than ever before.[vii]

Results from UCLA's Anderson Forecast spring update show the US unemployment rate peaking at approximately 13% in the fourth quarter of 2020, a total job loss of approximately 17 million. The forecast expects California's unemployment rate to be higher than for the US, predicting that it will peak at more than 16% with 2.2 million jobs lost in the state.[viii]

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ECONOMIC SAFETY VALVES OPEN

In response to the pandemic, the Federal Reserve Bank and the federal government took steps to manage economic fallout by enacting monetary and fiscal policies aimed at cushioning the impact. In early March, the Federal Reserve slashed interest rates to nearly zero percent.[ix]

Responding more quickly to the pandemic crisis than it did during the Great Recession of 2007-2009, the Federal Reserve has continued acting to keep financial markets functioning and credit available to the market, especially for small businesses.[x]

Congress has also acted quickly to provide relief, passing three bills in response to the crisis. The most significant bill—the $2 trillion CARES Act— includes $25 billion for public transportation relief.

FUNDING ADDRESSES TRANSPORTATION NEEDS

The $25 billion for public transportation would be apportioned through the Federal Transit Administration based on Fiscal Year (FY) 2020 funding formulas that account for regional population, ridership, and other factors. The CARES Act dictates that, in some cases, it would be up to states, localities, and other recipients to determine how much of the broad-ranging grants or other types of aid would be devoted to operations and how much to construction. Of the $25 billion transit funding provided under the CARES Act, the Los Angeles-Long Beach-Anaheim region has been allocated over $1.2 billion.[xi]

Economic Outlook

The COVID-19 situation remains highly dynamic and difficult to predict beyond the near-term. The ongoing nature of the pandemic makes it difficult to forecast the economic impact.

Current signs point to the economic impacts worsening before improving. If the federal stimulus packages provide the necessary cushioning in the interim and that normalcy resumes within a couple of months, the immediate economic hardship could be somewhat temporary. The resumption of the deferred consumption coupled with improvements in production and the supply chains are also likely to result in further improvements.

The decline in travel and fuel consumption will likewise cause the Highway Trust Fund's revenue to decline, which may affect states' Department of Transportation projects. However, the federal government is considering another relief bill related to infrastructure of up to $2 trillion. This bill could provide an influx of funding for the construction of new transportation projects and accelerate shovel-ready projects.

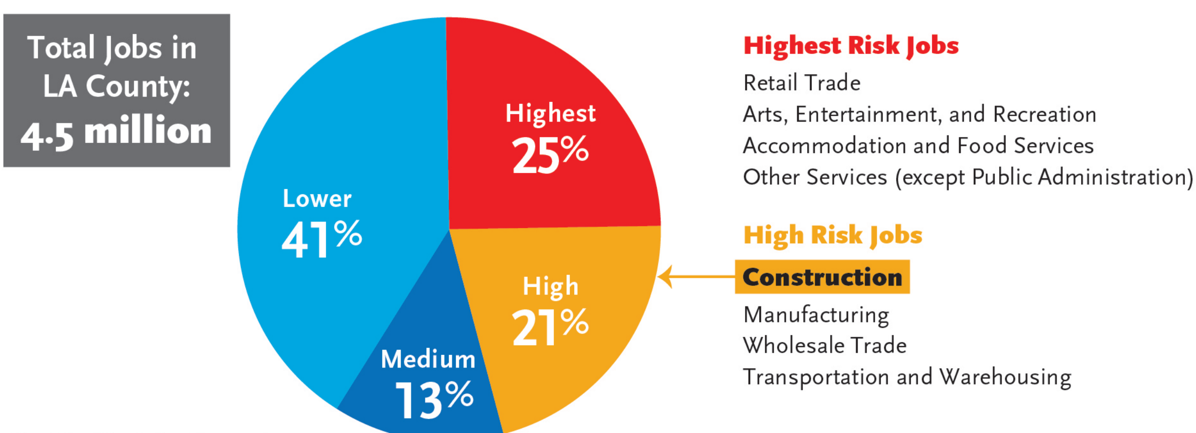
Challenges

- ✓ Economy is in a recession with the potential to fall into a depression
- ✓ Short-term labor shortages caused by health concerns
- ✓ Financial struggles for small business contractors
- ✓ Reduced/missed payments by financially distressed owners
- ✓ Cutbacks in public budgets

Opportunities

- ✓ Federal funding from stimulus packages
- ✓ Zero interest rates for financing projects
- ✓ Substantial price reductions on fuel and other commodities

AT RISK JOBS IN LA COUNTY*



**As defined by Oxford Economics*

Source: Los Angeles Economic Development Corporation

Construction Industry

Impacts

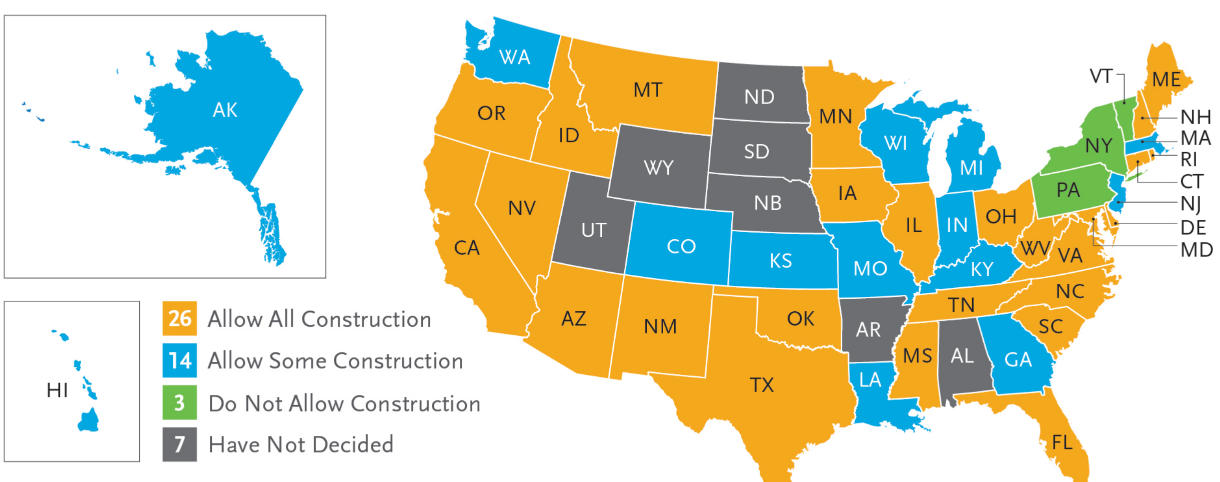
Parts of the country have shut down projects while others have deemed construction an essential service. Even if not mandated, an increasing number of owners are halting or canceling projects. This may be to help "enforce social distancing and other efforts to slow down the spread of the virus, or because demand for the project has dried up, at least temporarily, or because the owner's financial situation does not allow it to proceed," says Ken Simonson, chief economist at the Associated General Contractors of America (AGC).[xii]

The state, county, and citywide orders enacted around the country have left construction trade companies confused; they sometimes believe they are non-essential and must halt work, which is not always true. In many cases, companies providing supplies or services to the construction industry are exempt from statewide shutdowns of non-essential businesses. Some areas of the country have shut down all but essential construction work (such as infrastructure projects), while others have curbed specific types of construction (see map).

A shortage of specialty contractors (such as mechanical and electrical) could disrupt work because they are difficult to replace, and many states have rigid licensing laws. In other cases, subcontractors and suppliers have ceased operations if they cannot meet health guidelines, or subcontractors are proactively retreating from jobs they perceive as an unacceptable health risk.[xiii] Transportation agencies have had mixed reactions to the COVID-19 outbreak:

- **Chicago's Metra** has started several major construction projects to accelerate its 2020 construction to take advantage of service reductions due to the pandemic.[xiv]
- **Seattle's Sound Transit** has directed its contractors to suspend construction work, with limited exceptions, to support virus containment. Any continuing construction activities involve tasks considered to be critical or necessary to ensure safety or to avoid mobility, environmental, or other impacts.[xv]

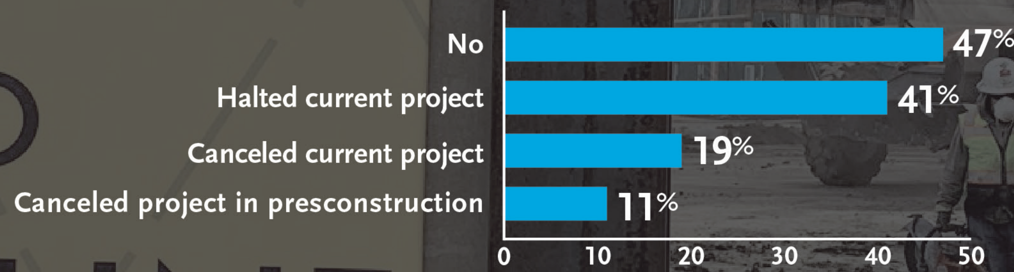
STATE GUIDANCE ON CONSTRUCTION PROJECTS



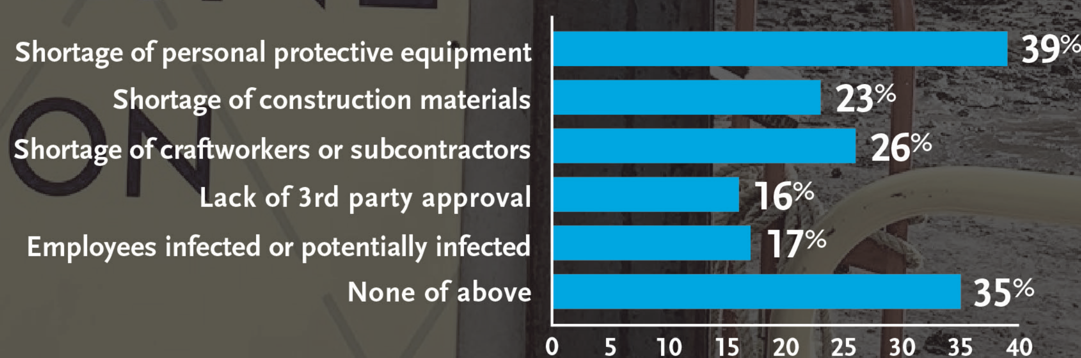
Source: Construction Dive

How has the coronavirus affected your work? *

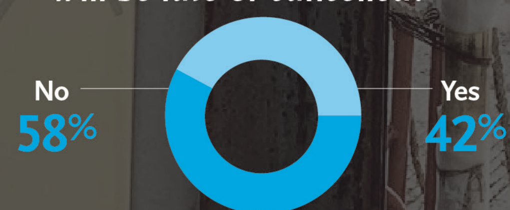
Did an owner direct you to halt or cancel work on any current projects or ones expected to start in the next 30 days? **



Are you currently experiencing any project delays or disruptions due to the following? **



Have any suppliers notified you or your subcontractors that their deliveries will be late or cancelled? **



*Source: * Construction Dive*
*** Associated General Contractors of America (AGC)*

Construction Outlook

Because the COVID-19 pandemic effects on the US is far from complete and no one can accurately predict its full impact, owners and contractors should be prepared for short-term labor shortages. With government-imposed preventative measures to reduce exposure to COVID-19 or other measures in cases of actual infections, it is fair to expect that contractors could experience significant effects on productivity, costs, and their ability to meet completion deadlines.

The economic slowdown in response to the pandemic has reduced prices for many construction materials. Material pricing is expected to fluctuate over the coming months and years as it is driven by supply and demand. With China's economy restarting and production approaching normal capacity, materials and products are starting to be provided at a more reasonable cost.[xvi]

Owners may table current projects until the uncertainty passes. While the national economy is entering a recession, construction in the non-residential market typically lags the overall economy by 12 to 18 months, according to Anirban Basu, Chief Economist for the Associated Builders and Contractors (ABC).[xvii] This means that most contractors who work for Metro can expect far more difficult circumstances next year because bids may be delayed, or even canceled, as owners reassess the pandemic's economic impact on new construction. Some new projects in sectors responding to the crisis, such as healthcare and manufacturing, will drive new constructions starts.

Challenges

- ✓ Reduction in number of construction firms due to reduced work and cash flow
- ✓ Productivity may slow and delay projects
- ✓ Supply chain issues
- ✓ Contractors across the country have started to issue notices of potential delays
- ✓ Revenue decline from toll roads and the Highway Trust Fund will dramatically decrease construction funding

Opportunities

- ✓ Labor pool increased
- ✓ Contractors are more available (will look to owners with locally generated revenues)
- ✓ Slow rebound in many commodity prices
- ✓ Innovation related to productivity and efficiency resulting from remote working

What Does this Mean for Metro?

The COVID-19 pandemic is a rapidly evolving event with elusive variables and unforeseen consequences. Society's response has been similar. Forecasting pandemic impacts and duration with any certainty is a largely futile prospect.

However, the past few weeks provide some insight to actual shorter-term consequences and data, along with several impacts and opportunities directly related to Metro's construction market situation. Metro can prepare for, or proactively manage, several potential actions that support progress toward strategic outcomes.

What Is Happening Now?

Revenue decline. Metro's ridership and sales tax revenue has plummeted, leaving the agency in unchartered territory. Sales tax generates roughly half of Metro's annual budget, and Metro could potentially lose between $650 million and $750 million in sales tax revenue by this fiscal year's end. Although fare collection is not Metro's primary significant source of revenue, it funds a third of operational costs for bus service and helps keep the system open longer than it would be otherwise. With the public "Safer at Home" order and non-essential businesses closed, people are traveling and spending dramatically less, and ridership is declining.

Productivity. Los Angeles County has been hit the hardest by the COVID-19 pandemic in California. Metro and contractors are likely to see disruptions, schedule delays, and productivity decreases on Metro projects as a consequence of canceled deliveries, lack of inspection approvals, and absent workers from social distancing and fear of infection on jobsites.

Owner of choice. Although revenue is down, Metro will continue to generate revenue and is likely to receive funding from future stimulus and infrastructure investments. Some state departments of transportation rely heavily on the Highway Trust Fund and toll road revenue to fund construction projects, and those agencies will likely cancel or delay future construction projects. As work dries up, contractors will look to owners with local, steady revenue sources, making Metro a top candidate for contractors to bid on future work.

Labor pool. The 2020 Construction Market Analysis anticipated a labor shortage that Metro will experience over the next 10 years while constructing its capital program. Now, the skyrocketing number of unemployment claims since the virus outbreak is likely to dramatically increase the labor pool. Metro should implement an aggressive outreach program about the jobs needed to support its construction program, and should continue supporting training programs helping workers to enter the construction market.

Construction acceleration. During this period of light traffic and temporary business closures resulting from the "Safer at Home" order, Metro is adjusting work schedules to allow contractors to work during daytime hours on weekdays. This adjustment is reducing community impact from nighttime and weekend work that otherwise would be required, and accelerating construction schedule. Specifically, this benefits Regional Connector and Purple Line extension construction.

Business closures and light traffic gave Metro the opportunity to close corridors and accelrate construction, which will accelerate economic recovery.

How Can Metro Respond?

The 2020 Construction Market Analysis provided recommendations based on three strategic plan outcomes to better position Metro in pre-pandemic conditions:

- Create a stronger, more resilient organization
- Be the owner of choice
- Increase the labor pool

Now, in a dramatically different economic scenario, these strategic outcomes are still valid. Furthermore, several immediate efforts previously identified still support these strategic outcomes in response to the COVID-19 pandemic. Further actions aligned to these outcomes should be considered in preparation for any additional potential impacts resulting from the pandemic and its effects. These potential actions are organized below based on the three strategic outcomes.

POTENTIAL ACTIONS ALIGNING WITH METRO'S STRATEGIC OUTCOMES

Create a Stronger, More Resilient Organization	Be the Owner of Choice	Increase the Labor Pool
✓ Review invoices to make sure that payments are made for work completed and financing requirements and notices are met as cashflow for contractors become more difficult. ✓ Understand contract provisions and insurance requirements that would allow for work to be suspended or terminated (prepare for force majeure clauses). ✓ Evaluate potential jobsite efficiencies to be realized by remote workers. ✓ Conduct supply chain audits and identify vulnerabilities.	✓ Continue to move projects forward as much as possible following the latest health and safety procedures to prevent the exposure and spread of COVID-19. ✓ Conduct bid walks and pre-bid meetings via videoconferencing to not delay procurements.	✓ Implement an aggressive outreach program to the recently unemployed and connect them with construction training and apprenticeship programs. ✓ Coordinate with workforce programs to develop virtual training programs and continue building a pipeline of qualified workers as the number of Metro projects under construction increases over the next few years.

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